

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 PM-05 INR-07 L-03 ACDA-07  
NSAE-00 PA-01 SS-15 PRS-01 SP-02 USIA-06 TRSE-00  
NSC-05 OMB-01 /066 W  
-----024764 090639Z /13/40

R 081218Z SEP 77  
FM USMISSION NATO  
TO SECSTATE WASHDC 5716  
SECDEF WASHDC  
INFO AMEMBASSY LONDON  
CINCLANT NORFOLK VA  
USLOSACLANT NORFOLK VA  
USNMR SHAPE BE  
USCINCEUR VAIHINGEN GER

C O N F I D E N T I A L SECTION 01 OF 02 NATO 08556

C O R R E C T E D C O P Y (ADDING PARA #7 FIRST LINE)

E.O. 11652: GDS  
TAGS: MPOL, NATO, UK  
SUBJECT: UK DEFENSE CUTS FOR 1978-79 - DPC MEETING  
SEPTEMBER 7, 1977

THE FOLLOWING ARE THE REMARKS OF THE UK CHARGE (PAUL C.  
HOLMER) PRESENTED TO THE DPC ON 7 SEPTEMBER DURING DIS-  
CUSSIONS ON THE DRAFT ANNEX OF PO/77/124, REDUCTIONS IN  
UNITED KINGDOM DEFENSE EXPENDITURE FOR 1978-1979.  
REPORTING MESSAGE SEPTEL. BEGIN TEXT:

1. MR CHAIRMAN:  
MY AUTHORITIES ARE VERY GRATEFUL FOR THE EFFORTS WHICH  
HAVE BEEN MADE BY THE ALLIANCE TO ENABLE US TO HAVE THIS  
DISCUSSION TODAY, SO EARLY IN SEPTEMBER. THE LETTER  
WHICH YOU SEND TO MR MULLEY WILL BE READ MOST ATTENTATIVELY  
BY MINISTERS IN LONDON, WHO WILL ALSO TAKE DUE NOTE OF THE  
COMMENTS YOU HAVE MADE THIS MORNING, AND THOSE OF AMBAS-  
SADORS AND OF THE CHAIRMAN OF THE MILITARY COMMITTEE,  
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WHICH WILL BE FULLY REPORTED. YOUR LETTER WILL BE A MOST  
IMPORTANT DOCUMENT IN THE CONTEXT OF THE DISCUSSIONS  
WHICH MINISTERS WILL BE HAVING IN LONDON THIS AUTUMN ABOUT  
THE LEVELS OF PUBLIC EXPENDITURE FOR THE YEARS 1979 AND  
LATER, AS WELL AS FOR CONSIDERING THE DETAILS OF THE DE-  
FENSE BUDGET FOR 1978/79. BECAUSE IT IS SUCH A KEY DOCU-  
CERTAIN AMENDMENTS TO THIS DRAFT LETTER WHICH, IN THE VIEW

OF MY AUTHORITIES, WILL ENSURE THAT ALL THE STATEMENTS IT MAKES CAN BE FULLY SUPPORTED IN SUBSEQUENT DISCUSSION.

2. IN GENERAL, HOWEVER, LET ME SAY THAT MY AUTHORITIES CONSIDER THAT THE DRAFT LETTER ATTACHED TO PO/77/124 WELL REFLECTS THE VERY USEFUL CONSULTATIONS WHICH TOOK PLACE IN LONDON, REFERRED TO IN YOUR COVER NOTE. WE NOTICE IN PARTICULAR THAT THE NATO AUTHORITIES RECOGNIZE THE JUDICIOUS SELECTION OF MEASURES ON WHICH IT IS PROPOSED THAT REDUCTIONS SHOULD FALL, AND THAT THERE IS NO ROOM LEFT FOR ALTERATIONS OR COMPENSATORY MEASURES TO BE PROPOSED. DETAILED AMENDMENTS WHICH MY AUTHORITIES HAVE INSTRUCTED ME TO PROPOSE. I THINK IT WILL BE CLEAR ENOUGH IN EVERY CASE WHY WE ARE SEEKING THESE CHANGES; MOST OF THEM ARE MINOR MATTERS OF LANGUAGE, BUT NEVERTHELESS IMPORTANT TO ENSURE THAT THE LETTER IS ACCEPTED BY MINISTERS IN LONDON AS A FAIR AND BALANCED STATEMENT OF THE UK CONTRIBUTION TO THE ALLIANCE. IN THREE CASES WE PROPOSE THE DELETION OF COMPLETE SENTENCES FROM THE DRAFT LETTER; HERE TOO THE REASONS SHOULD BE PRETTY PLAIN, BUT I WILL BE GLAD TO ENLARGE ON THEM IN DISCUSSION IF COLLEAGUES WISH.

4. AS REGARDS THE PUBLICATION OF A VERSION OF THIS LETTER, AS PROPOSED IN YOUR PO/77/127, WE ACCEPT THAT THIS IS NORMAL PRACTICE, AND INDEED THAT THERE ARE ADVANTAGES IN SO DOING, BECAUSE OF THE NEED TO EDUCATE PUBLIC OPINION.  
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HOWEVER, MR MULLEY WILL NEED TIME TO INFORM HIS MINISTERIAL COLLEAGUES ABOUT THE ALLIANCE'S COMMENTS ON THE UK PROPOSALS, AND SECURE THEIR FORMAL AGREEMENT TO PROCEED ACCORDINGLY, AND WE WOULD THEREFORE ASK FOR ONE OR TWO WEEK'S GRACE BEFORE PUBLICATION, DURING WHICH WE MAY ALSO WISH TO PROPOSE ONE OR TWO AMENDMENTS TO THE REVISED DRAFT SO AS TO ENSURE THAT IT IS IN ALL RESPECTS FIT FOR PUBLIC CONSUMPTION.

5. FINALLY, I THINK IT WOULD BE USEFUL TO THE COMMITTEE IF I MADE A BRIEF COMMENT ON THE REFERENCES TO THE BRITISH ECONOMY IN PARAGRAPH 5 OF THE DRAFT LETTER. THESE PAINT A VERY ATTRACTIVE PICTURE OF THE PROSPECTS WHICH I SINCERELY HOPE WILL TURN OUT TO BE AN ACCURATE PORTRAIT. OF COURSE I SHARE THE HOPE THAT THE UNITED KINGDOM'S WORST ECONOMIC DIFFICULTIES ARE OVER, OR MAY SOON BE OVER. BUT WHEN CONTEMPLATING POSSIBLE DEVELOPMENTS IN THE BRITISH ECONOMY OVER THE NEXT FEW YEARS CERTAIN CONSIDERATIONS MUST BE BORNE IN MIND.

6. AS REGARDS NORTH SEA OIL, THIS WILL CLEARLY HAVE A BENEFICIAL EFFECT ON THE CURRENT ACCOUNT OF THE UK BALANCE

OF PAYMENTS. IT HAS BEEN ESTIMATED THAT THE FAVORABLE EFFECT ON CURRENT ACCOUNT MIGHT REACH POUNDS 4 BILLION A YEAR BY 1980, COMPARED WITH A SITUATION IN WHICH WE HAD NO OIL. THIS IS NOT HOWEVER A PREDICTION OF THE CURRENT ACCOUNT SURPLUS THAT WE COULD EXPECT TO ENJOY IN THAT YEAR; NOR IS IT A MEASURE OF THE LIKELY IMPROVEMENT IN THE CURRENT ACCOUNT POSITION COMPARED WITH NOW.

7. THEN THERE IS THE IMPORTANT QUESTION OF DEBT PAYMENTS. A SIZEABLE CURRENT ACCOUNT SURPLUS WILL BE REQUIRED TO REPAY OFFICIAL OVERSEAS DEBT ON CAPITAL ACCOUNT. THE BURDEN OF UK DEBT REPAYMENTS WILL RISE STEEPLY TO 1981. BY WAY OF ILLUSTRATION, IN THE SIX YEARS 1979-84 THE SCHEDULED

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R 081218Z SEP 77  
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C O N F I D E N T I A L SECTION 02 OF 02 NATO 08556

REPAYMENT OF THE UK'S FOREIGN CURRENCY DEBT WILL AMOUNT TO \$17.5 BILLION, THAT IS AN AVERAGE OF NEARLY \$3 BILLION PER ANNUM. AS REGARDS THE PRESENT POSITION, ALTHOUGH OUR CURRENT FOREIGN CURRENCY RESERVES ARE AT A RECORD LEVEL, OFFICIAL OVERSEAS DEBTS AT PRESENT STILL EXCEED OUR RESOURCES BY A SUBSTANTIAL MARGIN.

8. AS REGARDS UK GOVERNMENT RECEIPTS FROM TAXES AND ROYALTIES ON NORTH SEA OIL, OUR LATEST TENTATIVE FORECAST FOR THIS REVENUE IS THAT, BY THE MID-1980S IT MAY AMOUNT (AT 1976 PRICES) TO POUNDS 3.5 BILLION A YEAR. THIS IS OF COURSE A SUBSTANTIAL SUM, WHICH SHOULD CONSIDERABLY EASE

MY GOVERNMENT'S FINANCIAL POSITION, BUT IT MUST BE REMEMBERED THAT THIS AMOUNT CANNOT SIMPLY BE SWITCHED DIRECTLY INTO PUBLIC EXPENDITURE. EVEN IF THE CASH IS AVAILABLE TO FINANCE PUBLIC EXPENDITURE THERE ARE OTHER IMPORTANT CLAIMS ON NATIONAL RESOURCES WHICH WILL HAVE TO BE TAKEN INTO ACCOUNT. FIRST THERE WILL BE THE NEED TO PROVIDE FOR INCREASED LEVELS OF INVESTMENT TO MODERNIZE AND STRENGTHEN

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OUR INDUSTRIAL BASE. SECOND, THERE IS BOUND TO BE THE NEED FOR SOME IMPROVEMENT IN LIVING STANDARDS AFTER THE SHARP REDUCTIONS NECESSITATED OVER PAST YEARS. I SHOULD EMPHASIZE THAT THE LATTER POINT DOES NOT IMPLY A FRITTERING AWAY OF BENEFITS OF NORTH SEA OIL BUT IS A REFLECTION, FOR EXAMPLE, OF THE NEED TO CUT RATES OF PERSONAL TAXATION IN ORDER TO GIVE GREATER INCENTIVES TO BOTH EMPLOYERS AND EMPLOYEES IN CONTRIBUTING TO NATIONAL ECONOMIC RECOVERY.

9. ALL THESE FACTORS WILL HAVE A BEARING ON THE RESOURCES WHICH MAY IN FUTURE YEARS BE ALLOCATED TO THE DEFENSE SECTOR. AS I SAID BEFORE, I MAKE THESE POINTS ONLY IN ORDER TO GIVE A MORE BALANCED PICTURE AND NOT IN ANY ATTEMPT TO PREDICT WHICH WAY THESE FUTURE DECISIONS WILL GO. AS REGARDS 1978/79, THE REDUCTIONS IN DEFENSE EXPENDITURE WILL AMOUNT TO RATHER LESS THAN 1 PERCENT, IN REAL TERMS, . THE COMMITTEE THAT THE VIEWS OF OUR ALLIES, AND THE IMPORTANCE OF THE 3 PERCENT TARGET ACCEPTED BY MINISTERS, WILL BE TAKEN FULLY INTO ACCOUNT. END TEXT. BENNETT

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